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(By fax: 2596 0729)

20 March 2002

Miss Denise YUE, JP
Secretary for the Treasury
Finance Bureau
4th floor, Main and East Wings
Central Government Offices
Hong Kong

Dear Miss YUE,

LegCo Panel on Financial Affairs

Follow-up to meeting on 14 March 2002

Target level and purposes of fiscal reserves

The LegCo Secretariat presented the research report on "Practices of Overseas Jurisdictions in Building up or Maintaining their Fiscal Reserves" to the Financial Affairs Panel on 14 March 2002. With regard to the target level and purposes of fiscal reserves, Members note that the former Financial Secretary (FS), when presenting the 1998-99 Budget, defined three purposes for which fiscal reserves are needed, namely, to meet operating, contingency and monetary requirements. The target level of fiscal reserves was accordingly set as the sum of 12 months' government expenditure and Hong Kong Dollar money supply under the M1 definition, with a margin of plus or minus 25%. In his 2002-03 Budget Speech, the incumbent FS announced a revised target level of fiscal reserves, i.e. a level equivalent to around 12 months of government expenditure to meet operating and contingency requirements. FS considers that there is no further need to link the level of fiscal reserves to money supply. However, the fiscal reserves will continue to be placed with the Exchange Fund, thereby providing even more resources for the Exchange Fund to maintain the stability of the Hong Kong Dollar and our monetary system.

While the incumbent FS has announced a revised basis for determining the target level of fiscal reserves, Members consider it not clear whether there have been any changes to the purposes of the fiscal reserves, and would like to seek clarification from the Administration in this regard. They are particularly concerned whether the Administration would use the fiscal reserves for monetary

purposes, such as for maintaining the stability of the Hong Kong Dollar and the local financial market, bearing in mind that the fiscal reserves continue to be placed with the Exchange Fund. I should be grateful for your response on this matter on or before **11 April 2002**.

In this connection, the Administration is requested to note that the Panel would further deliberate issues relating to the target level and purposes of the fiscal reserves upon receipt of further information from the Administration and other sources. Based upon the practices of other jurisdictions and academics' views, our Secretariat has suggested some issues for further consideration by Members. These issues are set out in section 29 of the aforesaid research report, copies of which have been forwarded to your bureau on 14 March 2002. Members have also requested further information relating to the investment incomes of the Government and I shall write to you separately on this.

Pursuant to Members' request, our Secretariat is collecting information on the practices of other jurisdictions, including the Mainland, in maintaining their foreign reserves. In this regard, the Administration is mostly welcome to provide suggestions, if any, of relevant literatures and/or other sources of relevant information.

With best regards,

Yours sincerely,

(Ms Anita SIT)
Clerk to Panel

c.c. Hon Ambrose LAU Hon-chuen, GBS, JP (Chairman)